Ongoing challenges that the SBA continues to work on in the IT arena include rising software costs as the Agency comes to rely on web-based delivery systems for its critical applications, and successfully resolving outstanding audit and system certification and accreditation review findings from prior examinations.

The MD&A, in addition to presenting a basic overview of the SBA and a discussion of performance information, must also contain information relating to the financial condition of the SBA as well as the SBA's compliance with Federal Government rules and regulations. The following pages will present highlights and analysis of financial results as well as reconciling the financial statements with the budgetary resources used by the performance section. The section will finish with a discussion of the SBA's internal controls, its compliance with the Federal Managers Federal Integrity Act and the Federal Financial Management Improvement Act, and Improper Payments.

ANALYSIS OF FINANCIAL RESULTS

The U.S. Small Business Administration prepares its financial statements as a critical aspect of ensuring the accountability and stewardship for the public resources entrusted to the SBA. These financial statements have been prepared to report the financial position and results of operations of the SBA, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the SBA's books and records in accordance with generally accepted accounting principles for federal entities and the formats prescribed by the OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U. S. Government, a sovereign entity.

Background

The SBA is the smallest of the major federal credit agencies, behind the Department of Agriculture, Department of Education, the Department of Housing and Urban Development and the Department of Veterans Affairs. However, unlike the other major federal credit agencies, almost all of the SBA's available budgetary resources, $4.0 billion budgetary and $18.6 billion non-budgetary loan financing funds, is devoted to its credit programs.

At September 30, 2006, the SBA had guarantied loan principal outstanding of $54.6 billion, up 7% from $51.1 billion guarantied loan principal outstanding at September 30, 2005, as restated, see below. The SBA's portfolio of direct and purchased guarantied loans receivable also continued to grow, valued at $6.4 billion this year, an increase of 52% over last fiscal year. This is due primarily to the disbursement of an unprecedented volume of disaster loans to the victims of Hurricanes Katrina, Rita and Wilma. The loan portfolio includes defaulted guarantied loans as well as loans made directly to the victims of natural disasters and in the Agency's business MicroLoan program.

The SBA's assets and liabilities are primarily the result of its credit program activities, and primarily consist of fund balances with Treasury, credit program receivables, liabilities for loan guaranties, and Treasury debt. The SBA's loans and guaranties are financed by a combination of subsidy appropriations, fees charged lenders and borrowers, and borrowings from Treasury. Congress provides appropriations to cover the estimated long term costs of SBA loans, which are defined as the net present value of the estimated cash outflows and inflows associated with the loans. The remaining portion of each direct loan disbursed is financed under permanent indefinite authority to borrow funds from the U.S. Department of the Treasury's Bureau of Public Debt. Borrowings are repaid to Treasury as loans are repaid to the SBA.

Credit program receivables for SBA are comprised of business and disaster direct loans and defaulted business loans purchased per the terms of the SBA's loan guaranty programs.

Restatement

During 2006, the SBA discovered an error in the presentation of guarantied loans outstanding. The amounts shown in FY2005 financial statements, Footnote 6K, as Guarantied Loans Outstanding, and in this Financial Analysis were overstated by $10 billion due to a data error in SBA's loan accounting system. The correction of the error has lowered each of the two FY2005 figures in Footnote 6C of the FY 2006 financial statements by $10 billion. There is no further impact of this correction in the SBA's financial statements or footnotes. Subsequent to the discovery of this error, the SBA implemented an internal control procedure to monitor general ledger and subsidiary account balances, as well as journal voucher activity, to assure that this type of error cannot occur in the future.

	FY2005	
	Reported	**Restated**
Total Principal Outstanding at Face Value	$73.3 billion	$63.3 billion
Total Principal Outstanding Guarantied by the SBA	61.1 billion	51.1 billion

Financial Position

Assets

The SBA had total assets of $13.2 billion at the end of 2006, up 11% over 2005. Assets increased primarily due to an increase in the net book value of credit program receivables that comprised 49% and 36% of total assets as of September 30, 2006 and 2005. Most credit program receivables are valued at the present value of expected future cash flows, per the provisions of the Federal Credit Reform Act of 1990. The 49% increase in credit program receivables over 2005 reflects the Agency's increased disbursements of disaster loans to the victims of Hurricanes Katrina, Rita and Wilma.

Liabilities

The SBA had total liabilities of $12.0 billion at the end of 2006, up 7% over 2005. Liabilities consist primarily of the Liability for Loan Guaranties, an estimate of the future amount the SBA will pay, net of fee collections, to liquidate expected purchases of guarantied loans under its guaranty loan programs, and Debt with Treasury, borrowed primarily to disburse loans under direct loan programs. The guaranty liability decreased 24.0% because the subsidy costs of the SBA's guarantied loan programs, broadly, are decreasing. Debt with Treasury increased 21% because of the increase in disaster loans disbursed.

Net Position

Net position, the sum of Unexpended Appropriations and Cumulative Results of Operations, increased in 2006 to $1.1 billion. Unexpended Appropriations increased due to emergency appropriations for hurricane relief received in 2006 and still available. The loss shown as Cumulative Results of Operations increased due to increased unfunded upward subsidy reestimates, from $492.5 million at September 30, 2005 to $773.8 million at September 30, 2006. This was due primarily to the upward portion of the disaster loan programs' reestimates increasing by $231.5 million.

Results of Operations

Each year, the estimated long term costs of the SBA's loans are reestimated for each major loan program. Reestimates update original loan program cost estimates, which are primarily due to expected defaults, to reflect actual experience and changes in forecasts of future cash flows. Increased reestimated costs are funded in the following year by permanent indefinite authority, while decreased costs are forwarded by the SBA to a Treasury general fund.

The 504 Certified Development Companies Program had the largest net reestimates among the guarantied business loan programs, $145.6 million downward. This was due to a change in economic assumption data distributed by the Department of Commerce and to better than previously projected program performance.

The Disaster Loan program delivered an increased amount of disaster loans to individuals and businesses in 2006 compared to 2005. The SBA disbursed $1.0 billion of disaster loans in 2005 and $3.7 billion in 2006. Because of the unprecedented volume of FY 2006 disaster disbursed loans, with another $5.4 billion of loans approved but not yet disbursed, a reestimate was done for the 2006 loans. The 2005 and 2006 cohorts of disaster loans accounted for most of the net $311.7 million upward reestimate in disaster loan programs.

Budgetary Resources

Total Budgetary Resources increased $7.9 billion from FY2005 to FY2006. This increase is due to an increase in borrowing authority in the nonbudgetary loan financing funds, although there were other offsetting changes of $1.1 billion (see below). Borrowing authority (see Background, above) increased by $7.9 billion from FY2005 to FY2006 in order to finance the approval and disbursement of disaster loans to Katrina and Rita hurricane victims. A record level in excess of $11 billion of Disaster loans was approved by SBA in FY2006 due primarily to Gulf Coast hurricane victims.

The other significant changes in the Budgetary Resources were decreases of $1.1 billion in appropriations received, offset by increases in the unobligated balance carry forward as well as other budgetary resources. Appropriations received consist primarily of funding for loan subsidies, upward subsidy re-estimates, and administrative expenses including salaries and expenses. The primary component of the $1.1 billion decrease was a decrease in the Business Loan Investment Fund of $1.5 billion for the funding of the upward portion of subsidy re-estimates. The SBA receives permanent indefinite appropriations for increases in the projected subsidy costs of loan programs as calculated by the annual reestimation process required by the Federal Credit Reform Act of 1990.

Status of Budgetary Resources

Total Status of Budgetary Resources increased $7.9 billion from FY2005 to FY2006. This increase is primarily due to an increase in obligations incurred in the nonbudgetary loan financing funds. $7.7 billion of the increase is related to additional obligations in the nonbudgetary loan financing funds due to the approvals for Gulf Coast hurricane victim disaster loans.

The other significant change in the Status of Budgetary Resources was an increase of $1 billion in ending unobligated balance, primarily in the nonbudgetary loan financing funds. Unobligated balances accumulate in these financing funds from program collections that are used primarily to repay the Treasury borrowings in the following year. The difference between the total budgetary resources (borrowing authority, appropriations received, etc.) and the obligations incurred during the year is the resulting ending unobligated balance, a function of all the other activity. The remainder of the change in Status of Budgetary Resources was attributable to a decrease of $.7 billion in the obligations incurred in the budgetary funds because the subsidy costs of the SBA's loan programs, broadly, are decreasing.

Credit Management

The SBA has extensive debt servicing and collection practices to ensure maximum recovery. Borrowers must disclose delinquent government debt. Credit reports identify delinquent debtors as well, and they are barred from obtaining SBA guaranteed loans unless the delinquency is resolved. The Agency actively uses Federal salary offset through Treasury and intends to implement administrative wage garnishment as soon as a technical amendment to SBA's regulations is published. All loan applicants must disclose their taxpayer identification numbers.

Debt servicing and collection procedures include the rapid disposition of loan collateral through the liquidation process. Procedures are used to maximize recovery and avoid acquiring title to collateral whenever possible.

Additionally, the SBA submits information about delinquent debt to the Treasury Cross-servicing Program, a centralized debt collection program administered by the Financial Management Service. Federal tax refunds, salary and retirement pay, social security benefits and other disbursements that would otherwise be paid to a delinquent borrower may be offset and remitted to the SBA for application to loan amounts outstanding and debts are referred to collection agencies for follow-up.

Finally, through the Office of Lender Oversight, the Agency rates and ranks lenders disbursing SBA-guarantied loans according to risk. Larger lenders are subject to on-site reviews. The risk analysis of lenders allows the SBA to focus resources on those lenders representing the most risk in terms of exposure and credit quality.

Certain cumulative information about loan disbursements, charge offs, and recoveries by specific loan program, both direct and guarantied, as well as a schedule summarized for all business loans is available at **www.sba.gov/cfo/reports.html.**

HIGHLIGHTS OF FINANCIAL RESULTS

(Dollars in Thousands)

	Unaudited		% change
AT END OF YEAR	**FY2006**	**FY2005**	**2005 to 2006**
Condensed Balance Sheet Data			
Fund Balance with Treasury	$ 6,653,612	$ 7,558,096	-11.97%
Credit Program Receivables	6,382,126	4,276,972	49.22%
All Other Assets	62,935	70,944	-11.29%
Total Assets	$ 13,098,673	11,906,012	10.02%
Liability for Loan Guaranties	1,630,821	2,145,462	-23.99%
Debt with Treasury	9,330,382	7,735,907	20.61%
Downward Reestimate Payable to Treasury	704,506	950,645	-25.89%
All Other Liabilities	367,463	456,349	-19.48%
Total Liabilities	12,033,172	11,288,363	6.60%
Unexpended Appropriations	1,839,288	1,110,131	65.68%
Cumulative Results of Operations	(773,787)	(492,482)	57.12%
Total Net Position	1,065,501	617,649	72.51%
Total Liabilities and Net Position	$ 13,098,673	$ 11,906,012	10.02%
FOR THE YEAR			
Statement of Net Cost by Strategic Goal			
Goal 1: Improve Small Business Environment	$ 42,874	$ 36,748	16.67%
Goal 2: Increase Small Business Success			
Loan Subsidy Cost including Reestimates*	(309,633)	(92,408)	235.07%
All Other Cost Net of Revenue	280,003	329,551	-15.04%
Goal 3: Restore Homes and Businesses after Disasters			
Loan Subsidy Cost including Reestimates	848,135	179,090	373.58%
All Other Cost Net of Revenue	541,415	283,093	91.25%
Costs Not Assigned	68,925	71,735	-3.92%
Total Net Cost of Operations	$ 1,471,719	$ 807,809	82.19%

**Negative Cost due to downward subsidy reestimates that reduce prior loan subsidy costs*

	FY2006	FY2005	% change 2005 to 2006
Statement of Net Cost by Expense Type			
Loan Subsidy Cost and Required Annual Reestimates	$ 538,502	$ 86,682	521.24%
Goal 1 Costs	42,874	36,748	16.67%
Goal 2 Costs not Subsidy or Reestimates	280,003	180,001	55.56%
Goal 3 Costs not Subsidy or Reestimates	541,415	283,093	91.25%
Congressional Initiative Grants	44,697	36,965	20.92%
Other Costs Not Assigned	24,228	34,770	-30.32%
Total Net Cost of Operations	$ 1,471,719	$ 658,259	123.58%
Condensed Statement of Budgetary Resources			
Appropriations & Budget Authority Received, Budgetary	$ 2,774,768	$ 3,894,521	-28.75%
Nonbudgetary Borrowing Authority	12,089,779	4,201,785	187.73%
Unobligated Balances Forward	6,721,314	6,376,273	5.41%
Other Budgetary Resources, net	965,521	179,053	439.24%
Total Budgetary Resources	$ 22,551,382	$ 14,651,632	53.92%
Obligations Incurred, Budgetary	3,130,065	3,853,667	-18.78%
Obligations Incurred, Nonbudgetary	11,750,289	4,076,651	188.23%
Balances, Available and Unavailable	7,671,028	6,721,314	14.13%
Total Status of Budgetary Resources	$ 22,551,382	$ 14,651,632	53.92%
Condensed Statement of Financing			
Obligations Incurred	$ 3,130,065	$ 3,853,667	-18.78%
Collections, Receipts, Other Financing Sources	5,151,264	(2,653,167)	-294.16%
Total Resources Used to Finance Activities	8,281,329	1,200,500	589.82%
Resources that Do Not Finance Net Cost of Operations	(7,535,941)	(862,229)	774.01%
Components of Net Cost not Requiring Resources	726,331	469,538	54.69%
Net Cost of Operations	$ 1,471,719	$ 807,809	82.19%

RECONCILIATION OF PERFORMANCE BUDGETARY RESOURCES WITH COSTS IN THE FINANCIAL STATEMENTS

The SBA reports its budgetary obligations incurred to accomplish the Agency's strategic objectives along with the performance results for these objectives. These strategic resources include credit subsidy obligations for loan approvals made in the SBA's Business and Disaster programs during FY 2006. In assessing performance results, the SBA does not include credit subsidy obligations determined during FY 2006 to be applicable to prior year loan approvals. The Combined Statement of Budgetary Resources includes administrative expenses in both SBA's program and salaries and expense funds because interagency transactions are not eliminated. The interagency transactions have been eliminated in the reconciliation below to allocate net resources obligated to performance objectives. Additionally, certain program expenses and non- strategic resources, primarily those of the Congressional Initiative Grants that do not relate to the Agency's operations, are not included in resources reported for SBA strategic goals.

As a result of the adjustments detailed above, Resources Reported for Strategic Goals include administrative expenses, primarily employee salaries and benefits and grant programs to assist small businesses, and obligations for the credit subsidy cost relating to loans approved during FY 2006.

A reconciliation of the resources reported for strategic goals in this report with obligations incurred per the Statement of Budgetary Resources follows:

(Dollars in thousands)

		FY 2006
Total Budgetary Obligations Reported	$	14,880,354
Less:		
Obligations incurred in nonbudgetary loan financing funds		(11,750,289)
Credit subsidy reestimates for prior year approvals - Business		(404,177)
Credit subsidy reestimates for prior year approvals - Disaster		(80,194)
Intra-Agency transfers of Administration funds		(320,134)
Other program obligations (SBG, loan liquidating funds)		(22,671)
Obligations not related to strategic goals (Congressional Grants, other)		(107,855)
Equals Resources Reported for Strategic Goals	$	2,195,034

Per the above table, $2.2 billion in budgetary resources was used by the SBA during FY 2006. The following table shows how those resources are allocated by Strategic Goal and Long-Term Objective. Also shown, are the SBA's overhead costs as related to Strategic Goal 4 which deals with the administration of the SBA and other collateral support services.

BUDGETARY RESOURCES ALLOCATED TO ACHIEVE RESULTS

FY 2006 Budgetary Resources		
Strategic Goal/Long-Term Objective		**($ in 000)**
Strategic Goal 1. Improve the economic environment for small businesses.		
Long-Term Objective 1.1: Minimize the regulatory burden on small businesses.		$10,475
Long-Term Objective 1.2: Simplify the interaction between small businesses and the Federal government through the use of the Internet and information technology.		$16,180
Long-Term Objective 1.3: Increase the effectiveness of Federal Agencies to provice opportunities for small businesses.		$29,862
Total Strategic Goal 1		**$56,517**
Strategic Goal 2. Increase small business success by bridging competitive opportunity gaps facing entrepreneurs.		
Long-Term Objective 2.1: Increase the positive impact of SBA assistance upon the number and success of small business startups.		$125,190
Long-Term Objective 2.2: Maximize the sustainability and growth of existing small businesses assisted by SBA.		$203,953
Long-Term Objective 2.3: Significantly increase successful small business ownership within segments of society facing competitive opportunity gaps. (These budgetary resources are already accounted for in LTOs 2.1 & 2.2)	$166,830	—
District Offices Counseling & Training		$16,208
Total Strategic Goal 2		**$345,351**
Strategic Goal 3: Restore Homes and Businesses Affected by Disaster		
Long-Term Objective 3.1 :Help restore homes and businesses affected by disaster		$1,793,166
Total Strategic Goal 3		**$1,793,166**
Total Resources Allocated by Strategic Goals		**$2,195,034**

Strategic Goal 4: Ensure that all SBA programs operate at maximum efficiency and effectiveness. *(These budgetary resources are treated as Overhead and have been allocated to Strategic Goals 1 thru 3 above.)*		
LTO 4.1 General Planning and Management		$30,005
LTO 4.2 Human Capital Mgmt and Policy		$2,806
LTO 4.3 Improved Financial Performance	$10,765	
LTO 4.3 Budget and Performance Integration	$2,873	
Total LTO 4.3		$13,638
LTO 4.4 Information Technology Management	$23,761	
LTO 4.4 E-Government	$4,047	
Total LTO 4.4		$27,808
LTO 4.5 Procurement and Administration	$13,870	
LTO 4.5 Competitive Sourcing	$524	
Total LTO 4.5		$14,394
Total Resources Allocated Above		**$88,651**